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March 20, 2019

Ex Parte

Marlene H. Dortch
Secretary
Federal Communications Commission
445 12th Street, SW
Washington, DC 20554

Re: *In the Matter of Rural Health Care Support Mechanism*, WC Docket No. 02-60; *Promoting Telehealth and Telemedicine in Rural America,* WC Docket No. 17-310

Dear Ms. Dortch:

On March 19, 2019, representatives of GCI Communication Corp. ("GCI")—Tina Pidgeon and Chris Nierman of GCI, and John Nakahata of Harris, Wiltshire & Grannis—met with Guilia McHenry, Tracy Waldon and Octavian Carare from the Office of Economics and Analytics. At this meeting, GCI conveyed concerns regarding recent guidance from the Wireline Competition Bureau ("WCB") addressing how participants in the Rural Health Care Program ("RHC Program," or "Program") should calculate permissible rural rates under 47 C.F.R. § 54.607. More specifically, as further set forth below, GCI argued that WCB's guidance does not reflect sound or consistent economic principles, and is therefore counterproductive and could both increase costs to the Universal Service Fund ("USF") and decrease participation in the Program.

I. Background

The Commission has an ongoing rulemaking about how to update the rules governing participation in the RHC Program.[1] In addition, last October, the WCB issued an order prescribing rates for GCI's services under the Program using a cost-of-service approach that cut charges by 26% for services already provided.[2] And most recently the WCB issued a Public

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[1] *Promoting Telehealth in Rural America*, Notice of Proposed Rulemaking and Order, FCC No. 17-164, WC Docket No. 17-310 (rel. Dec. 18, 2017) ("2017 Notice"); *see also* Comments of General Communication, Inc., WC Docket No. 17-310 (filed Feb. 2, 2018) ("GCI Opening Comments"); Reply Comments of General Communication, Inc., WC Docket No. 17-310 (filed Mar. 5, 2018).

[2] *See* Letter from Elizabeth Drogula, Deputy Div. Chief, Wireline Comp. Bur., to J. Nakahata & J. Bagg, Counsel for GCI (Oct. 10, 2018) ("Bureau Decision" or "Decision"); *see also* Application for Review of GCI Communication Corp., WC Docket No. 17-310 (filed Nov. 9, 2018) ("GCI Application for Review"); *Wireline Competition Bureau Seeks Comment on GCI Application for Review*, Public Notice, DA No. 19-8, WC Docket No. 17-310 (rel. Jan. 2, 2019) ("AFR Public Notice"); Supplement to GCI Application for Review, WC Docket No. 17-310

Notice that provided some, but not complete, guidance as to how participants in the RHC Telecom Program are supposed to set rates used in competitive bids.[3]

The RHC Telecom Program was established by Congress in 47 U.S.C. § 254(h)(1)(A) and is the only universal service support mechanism that is specified by statute. Section 254 permits eligible healthcare providers to pay the same rates for telecommunications connectivity as urban healthcare providers, and the USF pays the difference between the urban rate the healthcare provider pays and the rural rate they would otherwise have paid.

GCI's filings identified above discuss the impact and importance of the RHC Program in Alaska in detail, which GCI addressed only briefly in the meeting. In short, the program has had great success in improving healthcare delivery and outcomes and promoting rural infrastructure deployment in Alaska. Alaska is, of course, geographically and demographically unique. It is over four times the size of California, yet with an estimated population of only about 750,000, and it therefore presents unmatched impediments to the delivery and provision of quality healthcare.

For many of Alaska's residents, telemedicine is the only way to receive healthcare, and it is a mainstay of the state's healthcare providers. Alaska accordingly leads the way in developing innovative healthcare platforms and networks to reach rural residents, including a network of over 550 Community Health Aides/Practitioners serving more than 170 remote villages.[4] These providers use telemedicine to conduct triage; to determine when a patient can be treated locally rather than being flown to Anchorage; to enable the exchange of documents and images; to conduct patient education; and to provide doctor-led treatment, including psychiatry.[5] Indeed, as of 2016, there were only four psychiatrists in all of Alaska outside of Anchorage, Fairbanks and Juneau, and none of those were in northern or western Alaska.

To deliver healthcare in all of those remote regions, connectivity from the RHC Telecom Program is essential. GCI has played a fundamental role in the growth of broadband infrastructure to meet the resulting demand for services in Alaska, investing over $3 billion over the past three decades to bring modern communications services to remote parts of the state. For example, in 2008, GCI acquired United Utilities and its western Alaska network, from which GCI built out and deployed its TERRA network—western Alaska's *first* terrestrial middle-mile

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(filed Jan. 29, 2019); Reply Comments of GCI Communication Corp., WC Docket No. 17-310 (filed Feb. 19, 2019).

[3] *The Wireline Competition Bureau Provides Guidance Regarding the Commission's Rules for Determining Rural Rates in the Rural Health Care Telecommunications Program*, Public Notice, DA No. 19-92, WC Docket No. 02-60 (rel. Feb. 15, 2019) ("Public Notice"); Petition for Reconsideration of GCI Communication Corp., WC Docket Nos. 02-60, 17-130 (filed Mar. 18, 2019) ("GCI Petition for Reconsideration").

[4] *Welcome to the Alaska CHAP Program*, ALASKA COMMUNITY HEALTH AIDE PROGRAM http://www.akchap.org/html/home-page.html (last visited Mar. 14, 2019).

[5] Stewart Ferguson et al., *The Impact of Telehealth in Alaska*, ALASKA NATIVE TRIBAL HEALTH CONSORTIUM at 10-11 (Dec. 10, 2009), https://www.slideshare.net/HINZ/impact-of-telehealth-in-Alaska.

network connecting back to Anchorage and the internet. TERRA now delivers high speed broadband services to 45,000 Alaskans in 84 rural communities across an area the size of the state of Texas—but GCI simply could not have constructed the TERRA network without RHC Telecom Program revenues.

The pricing rules for the RHC Program date back to a very different regulatory era. Those rules were originally written in 1997, at a time of detailed rate regulation for local services and tariffed rates for nearly every service. Even at that time, however, the Commission recognized that competitive bidding should be the foundation of determining rural rates; it found that "fiscal responsibility compels us to require . . . competitive bids," which are "the most efficient means for ensuring that [Program participants] are informed about all of the choices available to them."[6] The rules therefore required competitive bidding for all services provided to RHC Program participants.[7]

But the Commission did not stop with that easy-to-implement, market-driven framework. It also promulgated a three-level regulatory backstop essentially second-guessing the results of the competitive bidding process. Specifically, Section 54.607 requires service providers to justify their rates using:

1. An average of rates charged to a commercial customer purchasing "identical or similar services . . . in the rural area in which the health care provider is located;" or
2. An average of tariffed or other publicly available rates offered by other carriers for the same or similar services in the same area over the same distance; or
3. An FCC (for interstate services) or state (for intrastate services) approved cost-based rate.[8]

Significantly, the Commission did not attempt in 1997 to analytically reconcile these backstop rules with the fact of competitive bidding. It nonetheless seems clear, however, that the rules in Section 54.607 were not intended to displace the competitive bidding that the Commission found to be "require[d]," but rather to "sanity check" competitive bidding results.

Since 1997, the Commission has continued to move decisively away from cost-based regulation and toward greater reliance on market-based rates. In 1999, the Commission detarriffed non-dominant interexchange carrier rates, finding that "it is highly unlikely that interexchange carriers that lack market power could successfully charge rates, or impose terms and conditions . . . that violate Section 201 or 202 of the Communications Act."[9] Of course, at

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6 *See Federal-State Joint Board on Universal Service*, Report & Order, 12 FCC Rcd. 8776, 9029 ¶ 480 (1997) ("*Universal Service First Report and Order*").

7 *Id.* at 9133 ¶ 686.

8 *See* 47 C.F.R. § 54.607.

9 *See, e.g., Policy & Rules Concerning the Interstate, Interexchange Marketplace*, Second Report & Order, 11 FCC Rcd. 20730 ¶ 21 (1996); *Policy & Rules Concerning the Interstate, Interexchange Marketplace*, Second Order on Reconsideration, 14 FCC Rcd. 6004 (1999) (following remand of the first decision by the D.C. Circuit).

that time, the packet-based Ethernet services that HCPs often now require did not exist for commercial service, but the introduction of such services saw further deregulation. Today, *no* packet-based business data services ("BDS") are subject to rate or tariffing regulation,[10] and even DS-1 and DS-3 special access services are being mandatorily detariffed across the vast majority of the country.[11]

The Commission has not yet updated its RHC Program rules in the face of these changes, although that could certainly be done through the ongoing rulemaking. In the meantime, however, the Bureau's and USAC's current interpretations mandate that carriers disregard evidence of market pricing in favor of highly regulatory cost-of-service ratemaking—which has never before been imposed on non-dominant carriers for detariffed services. The result is unpredictability and uncertainty for all Program participants. In particular, providers like GCI can no longer be certain when they bid what their actual rates will be, rendering long-term investment planning extremely uncertain.

II. Discussion

A. The Bureau's Current Interpretations Show Insufficient Regard for the Outcome of Competitive Bidding in Competitive Markets.

As set forth above, all RHC Telecom Program circuits must be put out for competitive bid. And HCPs are required to select the most cost-effective bidder with price as a predominant consideration.[12]

Moreover, all or nearly all of these services—and all those that GCI sells—are in markets that the Commission has detariffed, either interexchange or BDS. Significantly, the Commission has opted to deregulate these markets and has mandated detariffing for these services both where competition is fully developed *and* where it continues to emerge. As the Commission indicated in the *BDS Order*, "[w]e further find that packet-based services are best not subjected to tariffing and price cap regulation, *even in the absence of a nearby competitor*."[13] The Commission found that *potential* competitors constrain BDS "pricing by . . . participating in similar customer service bidding requests" even "without any physical presence of the potential competitor in the nearby geography."[14] There is simply no coherent basis for applying strict regulatory rate reviews to RHC-purchased services, *which are also BDS or interexchange*, while applying no

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[10] *See Business Data Services in an Internet Protocol Environment*, Report & Order, 32 FCC Rcd. 3459, 3557 ¶ 237 (2017) ("*BDS Order*"); *In the Matter of Regulation of Business Data Services for Rate-of-Return Local Exchange Carriers*, 2018 WL 5311437, *1-2 ¶¶ 1-4 (Oct. 23, 2018) (detariffing BDS for rate-of-return carriers receiving high cost support).

[11] *See* 47 C.F.R. §§ 61.201 (Price Cap ILECs), 61.203 (CLECs), 61.50 (Rate-of-Return ILECs)

[12] *See, e.g., Rural Health Care Support Mechanism*, Report & Order, 27 FCC Rcd. 16678, 16765 ¶ 195 (2012) ("We emphasize that HCPs must select the most cost-effective bid . . .").

[13] *BDS Order*, at 3500 ¶ 88 (emphasis added).

[14] *Id.* at 3490 ¶ 67.

such reviews to purchases of the same services by non-healthcare providers outside of the RHC context. The distinction is entirely arbitrary.

Moreover, the Alaska market *is* competitive, not just potentially competitive. All areas can be served by four facilities-based satellite providers, and there are additional terrestrial networks to some areas, including western and northern Alaska. The Requests for Proposals ("RFPs") issued by HCPs under the RHC Telecom Program often attract multiple bidders, such as ACS, Leonardo DRS, AT&T, and GCI. Indeed, GCI has lost approximately 50% of competitive bids. In these circumstances—where services for RHC providers *are* "subject to competition"—the Commission has correctly found that "anchor or benchmark pricing is unnecessary and could in fact inhibit investment in this dynamic market by preventing providers from being able to obtain adequate returns on capital."[15]

In prescribing rates for GCI, however, the Bureau did not even attempt to explain why a complex multilayered backstop to competitive bidding continues to be necessary in a competitive telecommunications market—and then, as discussed further below, it exacerbated the problem by narrowly construing the rules to ignore relevant evidence of competitive market rates. Notably, the Healthcare Connect Fund, which the Commission created in 2012, has no such rate regulation backstop. In keeping with the Commission's focus on the importance of sound economic analysis, the RHC Program Rules should be dramatically simplified and aligned with economic principles and conclusions that the Commission has already applied to the same services outside of the RHC context. With respect to specific services in a particular geographic market, there should only be one set of pricing rules for the market, including both the RHC Program and sales to other users.

B. The Bureau's Guidance Requires Service Providers to Ignore the Best Evidence of Reasonable, Market-Based Rates When Applying the Backstop Benchmarks.

As has already occurred in Alaska, the Bureau's recent Public Notice regarding rural rates under Section 54.607 will force service providers to ignore the *best evidence of permissible rates*—the market rates for their services—because of the narrow view of comparable rates that the guidance adopts. This is both inconsistent with Commission precedent and illogical: It should be beyond dispute that market evidence of reasonable rates is better than cost-of-service studies. Yet the Bureau, both in prescribing GCI's rates and in its recent Public Notice, adopted several interpretations of the backstop rules that will push nearly all providers to using cost studies to justify their rates.

As a practical matter, in many rural areas, there simply are no purchasers of bandwidth comparable to that purchased by an HCP within the same community. GCI has accordingly compared its middle-mile rates to other similar middle-mile sales in other communities. This is consistent with the Commission's overall general approach to geographic markets, under which market delineation cannot be determined with "scientific precision" based on area, but rather "must . . . correspond to the commercial realities of the industry."[16] For channel terminations, GCI looked to the ILEC's publicly available tariffed rates.

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[15] *Id.* at 3500 ¶ 87.

[16] *Id.* at 3479 ¶ 39.

The Bureau, however, rejected in two related ways this method of justifying rates by combining market-based rates with publicly available tariffed rates. First, the Bureau's guidance indicates that "any rate used to determine a rural rate using Method 1 or 2 must be the rate actually charged to the customer . . . *for the entire service* and must appear on an invoice, contract, or other acceptable form of documentation as the entire charge for *a complete end-to-end service*."[17] This precludes middle-mile to middle-mile comparisons when different channel terminations (such as in different LEC areas) are used. In addition, the Public Notice states that "Methods 1, 2 and 3 must be applied sequentially,"[18] thus preventing providers from justifying part of a circuit using comparable sales to commercial customers and part using publicly available tariffs. This effectively excludes Method 2 comparisons for circuits that includemandatorily-detariffed interexchange middle-mile transport. The result of these two interpretations is to drive providers into cost studies—which are far less reliable than market evidence as a basis for rate-setting.

The Bureau has not offered any legal basis for these requirements, either by statute or through any rigorous analysis of Commission precedent.[19] But even more important, these requirements are economically irrational. There is simply no reason why combining different kinds of competitively defensible rates for different elements of an end-to-end circuit would not also produce a reliable rate for the entire end-to-end circuit: when all components are priced at reasonable, market-based rates, the sum of the parts must also be reasonable. If there is no market power across each piece, there can be no market power across the whole. At a minimum, however, it is beyond dispute that combining competitively defensible component rates to produce a sum for an entire end-to-end circuit is *more* reliable than a cost study. The *only* result of the Bureau's approach is to exclude valid market evidence of reasonable pricing.

In addition, the Bureau—again, both specifically in connection with GCI and in the Public Notice[20]—ignored the impact of volume and term discounts when reviewing rates. This discourages volume and term pricing, which is both economically irrational and counterproductive because it discourages lowering rates. The Public Notice further requires that providers exclude from the comparability analysis the different technologies and network configurations used to provide the service.[21] But such factors can be critically important considerations in whether services are, in fact, "similar for pricing purposes. Ignoring them is, again, economically irrational.

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[17] Public Notice at 3-4 (emphasis added).

[18] *Id.* at 3.

[19] The Public Notice does cite to the *Universal Service First Report and Order* for the proposition that comparables are limited to entire end-to-end circuits. Public Notice at 3-4. But the Commission's discussion there had nothing to do with what kinds of comparables may be used to determine a rural rate—it simply found that the entire end-to-end circuit is eligible for *support* under Section 254. *See* GCI Petition for Reconsideration at 10-12.

[20] Public Notice at 4.

[21] *Id.*

Finally, although this is not addressed in the Public Notice, the Bureau has barred per-Mbps rate comparisons in calculating "average" rates under Section 54.607. The Commission's outdated safe harbor categories establish a range of circuit bandwidths—*e.g.*, 1.5 to 8 Mbps and 8.1 to 50 Mbps—that can be considered "identical or similar services," but the rules do not say *how* to calculate an *average* within those ranges. By rejecting per-Mbps calculations, the Bureau is saying that the permitted rural rate for 1.5 Mbps circuit will be exactly the same as a rate for an 8 Mbps circuit, and the permitted rural rate for a 10 Mbps circuit will be exactly the same as a 50 Mbps circuit, even though an 8 Mbps circuit substitutes for five T-1s and a 50 Mbps circuit substitutes for five 10 Mbps circuits. This creates irrational incentives where a carrier could be better off selling five 1.5 Mbps T-1s rather than an 8 Mbps Ethernet circuit, or a five 10 Mbps Ethernet circuits rather than one 50 Mbps Ethernet circuit. Again, there is simply no rational economic basis for this approach.

C. Cost-of-Service Regulation is Disfavored and Error-Prone.

The practical result of the Bureau interpretations discussed above will be to force service providers to rely far more on cost studies to determine rural rates. But the Commission has never before used cost-of-service regulation for non-dominant carriers. And this approach carries a substantial risk of false positives, *i.e.*, showing rates of return that exceed those that the service provider actually experiences. Such falsely high rate-of-return calculations will lead to artificially depressed rates, which will in turn reduce network investment.

GCI has specific recent experience with the problems of using cost-of-service regulation to set rural rates. As GCI has argued in its recent filings, in using cost-of-service to prescribe GCI's rates, the Bureau erroneously:

- Ignored the BDS Order's observations about the potential for regulatory error in prescribing rates, and the impact that setting rates too low has on investment in facilities deployment.[22]
- For services over multiproduct networks, required cost allocation not just to the level of the facilities (*e.g.*, TERRA), but to specific customers served on the facilities (rural healthcare providers). This maximizes the cost allocation problems, and meant that even if GCI were not earning an "excessive" profit on the entire TERRA facility and was not cross-subsidizing any service provided over the TERRA facility, it could still have its rates to rural healthcare providers cut.[23]
- Ignored extant economic literature about the arbitrariness of fully-distributed cost allocation, and the problem that in a competitive market it can lead to underrecovery of costs. We provided an article by Baumol, Koehn and Willig making this point.[24]

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[22] *See, e.g.,* Additional Comments of General Communication, Inc. at 17-18, WC Docket No. 17-310 (filed Feb. 13, 2019) ("GCI Additional Comments"); GCI Application for Review at 11-15.

[23] *See, e.g.,* GCI Additional Comments at 23-28.

[24] *See, e.g.,* GCI Application for Review at 13-14.

- Failed to recognize that in competitive markets, common costs are recovered in accordance with demand. The Bureau rejected revenue based allocation, and insisted on bandwidth-based allocation.[25]
- Imposed the ILEC-prescribed rate of return without discussing the differences in risk between an ILEC with pooling and an IXC without pooling, or any other relevant factors.[26]

Notably, the negative systemic effects of reliance on cost-of-service based regulation are magnified if they are repeated year to year—which has, of course, contributed to the Commission's move *away* from rate-of-return regulation.

D. The Commission Should Adopt Reforms Increasing Transparency and Market Efficiency.

For all of the reasons discussed above and in GCI's recent filings, driving providers to cost-of-service regulation is not an approach based on sound economics, and will not benefit the RHC Program either in the near term or longer term in the rulemaking.

But revisions to the Commission's rules can play an important role in increasing Program transparency and enhancing market efficiency. One such economically sound reform would be to use forbearance to increase co-payments by healthcare providers. This should be done modestly and incrementally so that providers have time to transition, but could improve market efficiency by strengthening incentives for HCPs to ensure than they are making cost-effective purchases.[27]

The RHC Program would also benefit from adopting some of the transparency requirements of the E-rate Program to facilitate better market function. For example, the E-rate Program makes the supported services and amounts charged public, so schools and libraries can compare them and evaluate bids submitted by providers with greater knowledge of the market rates. The RHC Program rules could likewise require making more pricing information publicly available, which will help HCPs to compare their rates to those of other similarly situated entities.[28]

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[25] *See, e.g.,* GCI Additional Comments at 25-28.

[26] *See, e.g.,* GCI Application for Review at 15-16.

[27] *See* GCI Additional Reply Comments at 8-10.

[28] *See, e.g., id.*

Please contact the undersigned if you have any questions.

Sincerely,

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